EXPOSURE DRAFT

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Elements of Accounting and Financial Reporting in the Federal Government

United States General Accounting Office

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UNITED STATES GENERAL ACCOUNTING OFFICE

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DIVISION OF FINANCIAL AND
GENERAL MANAGEMENT STUDIES

The Accounting and Auditing Act of 1950 makes GAO responsible for establishing the accounting standards that Federal agencies are to follow. GAO established such standards in 1952 and has since revised them periodically. In recent years, there have been many advances in accounting theory and practice, and we, in light of these advances, deem it prudent to reexamine these standards on a conceptual basis to see if changes are needed or desirable.

Our first goal is to develop a conceptual framework under which consistent Federal accounting requirements can be maintained. Then the accounting reporting and operational requirements will be reevaluated to determine the needed changes. This effort is forward-looking, and the expected long-range benefit is more useful financial information.

This effort is divided into four stages: objectives, fundamentals, standards, and operational criteria. The objectives and the fundamentals constitute the conceptual framework. Objectives set forth the goals toward which accounting and financial reporting are directed. Fundamentals are concepts which serve as guidelines for determining and establishing standards. Standards are the rules for reporting financial activities and events. Operational criteria are the procedural or detailed system aspects that facilitate application of the standards. Initial work on the first stage, objectives, was recently completed, and an exposure draft was issued for comment.

This document addresses the first item in the fundamental concept level, namely, the elements of financial reporting. Elements are the components of financial reports and deal mainly with definitions of various types of resources, rights to resources, and changes in them. Other items to be addressed in the fundamental level are valuation and measurement concepts, identification of the reporting entity, and recognition concepts.

Similar efforts are underway by the Financial Accounting Standards Board (FASB), the private sector standard-setting body, and the National Council on Governmental Accounting (NCGA), the recognized standard-setting body for State and local governments. The FASB has recently issued an exposure draft on the elements related to the private sector. The NCGA is now doing research for State and local government accounting, but has not yet issued any exposure drafts.

Although the FASB has done much to establish elements in the private sector, we do not believe such elements unquestionably apply to the Federal sector. We believe that the Federal Government is sufficiently different from profit and nonprofit entities in the private sector to warrant separate studies on accounting and financial reporting and to warrant developing a separate conceptual framework which includes elements. The basic differences between the private sector and the Federal sector lie in the environment in which each operates. The environment has a pervasive influence on accounting and financial reporting, and this difference is best shown by the differences in the objectives statements of each. Nevertheless, some of the elements included in the FASB exposure draft applicable to business enterprises also apply to the Federal Government and have been included in this exposure draft. However, many elements, especially those depicting operations, are different. In developing the elements, we drew upon the FASB's work, as well as the work of the NCGA to the extent it could be applied to the Federal sector.

This document is issued as an exposure draft to Federal agencies, to members of the accounting profession and the academic community, and to other interested persons in the financial community. We solicit your comments on how it can be improved and whether the elements defined are appropriate for the Federal Government both conceptually and realistically. Please send these comments by November 14, 1980, to:

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Sincerely yours,

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ELEMENTS OF ACCOUNTING AND FINANCIAL REPORTING IN THE FEDERAL GOVERNMENT

INTRODUCTION

1. The overall accounting and financial reporting structure in the Federal Government has two major components: the conceptual framework and the practice requirements. The conceptual framework consists of two levels: the objectives, which were established in the exposure draft entitled "Objectives of Accounting and Financial Reporting in the Federal Government," dated February 29, 1980, and the fundamental concepts, which include the elements covered by this statement. The practice requirements also consist of two levels: the standards and the operational criteria. The second level builds upon the basis provided by the first level, the third builds upon the second, and so on.

2. This is the first statement on the fundamental concept level. Fundamental concepts are the initial steps to achieving the objectives. They are pragmatic principles that are broad in coverage and provide the framework within which accounting practice must be contained. This statement covers one of the fundamental concepts--the elements of financial reports. Elements are the definitions and classifications of resources, rights to resources, and changes in them as presented in financial reports. Other concepts that will be covered by

other statements include measurement and valuation concepts and recognition concepts. Figures 1 and 2 describe the planning efforts in the fundamental concept level.

3. This statement does not specify accounting standards, procedural requirements, or reporting standards as does GAO's "Policy and Procedures Manual for Guidance of Federal Agencies." Rather, it is intended to provide the basis for interpreting, establishing, and maintaining standards. Although the definitions in this statement may not be consistent with those in the manual, at a later date we will reevaluate the manual requirements and make appropriate additions, deletions, or other modifications on the basis of adopting the conceptual framework.

4. Federal agency accounting, as set forth in the Budget and Accounting Procedures Act of 1950, requires the use of accrual accounting. Also, Public Law 84-863 of 1956 (untitled) specifies that each executive agency head shall maintain his agency's accounts on an accrual basis. Because of this requirement, the elements discussed in this statement are based on the accrual method of accounting which recognizes transactions and events or circumstances affecting a governmental entity in the period they occur rather than when cash is received or paid.

ELEMENTS SUMMARIZED

5. **Financial reports** focus on economic resources **of** the reporting entity. Economic resources are generally considered items of value to society, individuals, and entities and as such are expected to yield benefits. Because of their value nature, all known economic resources are correspondingly claimed by society, individuals, or entities. Therefore, all resources are equal to the corresponding claim to them. Elements are the classifications of economic resources, corresponding claims to resources, and related changes in them. As such, elements are defined as the component parts of financial reports--"the building blocks"--used to construct reports. As component parts of financial statements, elements give users information to help assess an entity's financial viability, program activity, and fiscal compliance.

6. This statement identifies and discusses seven elements of financial reports of the Federal Government: assets, liabilities, equity of the U.S. Government, income, costs, gains and losses, and the results of operations. Assets are essentially the economic resources of an entity; liabilities and equity are essentially the corresponding claims to the resources; and income, costs, gains and losses, and results of operations are essentially the changes in them.

7. This statement defines and describes the characteristics of each element. It also sets forth the general criteria for

determining whether transactions or components of transactions qualify as elements that must be reported by entities. In addition, this statement discusses certain concepts which are related to the elements and which are intended to help provide a complete understanding of them. The relationship of the elements to the objectives is also discussed.

THE RELATIONSHIP OF ELEMENTS TO THE OBJECTIVES

8. The exposure draft entitled "Objectives of Accounting and Financial Reporting in the Federal Government" establishes the objectives of the Federal sector. These objectives center around the users of financial reporting and their need for information to assess management's performance and stewardship and to help determine resource allocations. Such information must first focus on the entity's financial viability, program activity, and fiscal compliance. This information must be presented in terms of the entity's economic resources and the creation, use, and rights to them. Financial reports are the basic means of communicating this information, and the elements are the basic classifications used to construct the financial reports.

9. As stated in paragraph 12 of the above exposure draft, financial reports (and, therefore, the elements) must focus on economic resources in order to indicate an entity's financial viability, program activity, and fiscal compliance. Financial

viability is an entity's ability to provide the same level of resources that it either has provided in the past or has indicated it expects to provide in the future. Elements describe financial viability in terms of resources and their related obligations, liabilities, and other claims to these resources, along with the changes in them. Program activity information must focus on the use of resources as inputs and outputs under various programs and projects. Elements help to show inputs and outputs by describing economic resources used and distributed in terms of income, costs, and gains and losses. The elements of income, costs, and gains and losses also help show an entity's fiscal compliance by allowing comparisons of these elements with external legal and regulatory limitations.

SCOPE OF ELEMENTS

10. The objective of accounting and financial reporting is to provide useful information in financial reports. Financial information has traditionally been presented in financial statements; however, as indicated in the objectives statement (par. 9), some financial information can be presented better, or presented only, by other means. The elements of accounting have traditionally been presented in financial statements of condition, operations, and changes in condition. However, segments of financial reports other than the statements must also focus on economic resources, claims to resources, and changes in them, and as a result, must be stated in terms of

elements. Although elements are the primary components of financial statements, they are also an integral part of other components of financial reports.

11. Financial reports contain basically three forms of data: quantified amounts in financial statements, other quantified amounts, and nonquantified data as expressed in words or other symbols. These three forms deal with economic resource information and, as such, are represented by the elements. Quantified amounts in financial statements depict elements usually in terms of dollars. Quantified amounts of elements not in financial statements can be presented in narratives, graphs, matrices, or tables. Nonquantified data on elements can include descriptions of various qualitative characteristics of resources or claims to resources, or it can include descriptions of the type of transaction within a program that results in an expenditure.

12. As previously defined in paragraph 5, elements are classifications of economic resources, claims to resources, and related changes in them. The elements defined in this statement can be divided into two major types. The first represents the resources and claims to them at a moment in time. Its focus is an instant of time. The second type represents the changes in the first type as a result of transactions, events, or circumstances. Although the second type

results from each transaction, event, or circumstance, it has traditionally been considered as a result of the cumulative affect of many transactions, events, or circumstances over a period of time. The interrelationship between the first and second type is very important. The elements of the first type are increased or decreased by elements of the second type, whether the elements of the second type are viewed as one transaction or event at a particular time or as the cumulative affect of many transactions or events. (See results of operations, par. 21.)

13. This division of elements into types and the relationship between the types are most clearly displayed in traditional financial statements. In financial statements, these two types of elements support each other. Elements defined in this statement of the first type are assets, liabilities, and equity in the U.S. Government. Elements of the second type are income, costs, gains and losses, and results of operations. For example, cash is an economic resource (an asset) of the first type. It is changed by a transaction--the second type--when salaries (a cost) are paid to employees. Cash is reduced as a result of the cost.

LIMITATIONS OF ELEMENTS

14. The purpose of this statement is to identify and define the basic elements which appear in financial reports. The elements identified and their definitions are broad in nature

and are intended to provide uniform guidance in subsequent efforts on the fundamental level of the conceptual framework and later work on the standards. Although this statement clarifies numerous questions and issues and will prove useful in later work on the accounting structure, certain inherent limitations in it should be noted.

15. First, as previously mentioned, the elements in this statement are general and broad. Each can readily be further divided into many categories. For example, assets can be divided into fixed property; intangible property; or property intended to be fully consumed within a short period, such as supplies inventory. The preparation of financial reports, especially the financial statements in them, normally requires such division of assets. However, this statement is not intended to provide a direct basis for preparing reports, but rather to provide a frame of reference from which detailed reporting standards can be interpreted, established, and maintained.

16. Also, some elements in this statement relate to the budget and are not limited to accounting and financial reporting. The characteristics of these items and their definitions as elements should be the same as those used in budget terminology. However, caution should be exercised when applying this statement to budgeting. For budgetary terms and their definitions, Office of Management and Budget Circular A-34 is the official document to use for the Federal Government.

17. This statement defines only the nature and the essential characteristics of the seven elements identified. Other matters concerning them, such as when to recognize an element, how to measure an element, and how to display one, will be discussed in other statements about the fundamental level, as well as statements resulting from work on the standard level.

ELEMENTS

18. The following paragraphs define the seven major elements of Federal accounting and financial reports. They are: assets, liabilities, equity of the U.S. Government, results of operations, income, costs, and gains and losses.

19. Assets. Assets are economic resources obtained and controlled by a particular governmental entity as a result of past transactions, events, or circumstances affecting the entity which help enable it to achieve its mission.

Characteristics of assets.

A. The three essential characteristics of assets are (1) probable future economic benefits exist to the entity by using assets either singly or together which help it achieve its mission, (2) the transaction, event, or circumstance giving rise to the entity's claim or control of the benefits has occurred, and (3) the entity can control others' access to the assets. Generally, to qualify as an asset, an item must have all three characteristics. Probable future economic benefit means that either directly or indirectly assets are likely, at least to some degree, to help an agency achieve its program objectives. The transaction, event, or circumstance giving rise to the entity's claim to and ability to control others' access to the asset refers to legal title, equity rights and claims, or otherwise possession of it. Traditionally, legal title has generally been the criterion for an item to qualify as an asset; however, equity rights and claims by themselves may provide the criterion. Equity rights may result from an interest in a benefit (an asset) acquired through an exchange of other benefits. An equity right may also be legally enforceable. However, legally enforceable claims to benefits is not the only prerequisite to qualify an item as an asset. Probable future benefit may result from possession of an item. Possession itself does not always qualify as claim to a benefit or the ability to restrict others' access to it; this would be the case if the asset were in transit. However, possession and intended use of an item without a legally enforceable claim may qualify the item as an asset.

B. Assets can be tangible or intangible; natural, manufactured, or constructed; or exchangeable or useable by the entity in producing and distributing goods and services to society, individuals, or other entities. Tangible assets can consist of a multitude of items, including nearly anything containing physical properties and having physical existence. Intangible assets have traditionally been defined as the opposite of tangible assets; i.e., they lack physical existence. Although the exact boundaries between tangible and intangible are not so clear, intangibles are generally considered to have more uncertainty concerning future benefits than do tangible assets. The exchangeable or useable characteristics of an asset are not limited to a specifically identifiable good or service to society, individuals, or other entities, nor are they limited to directly producing or distributing goods or services which are readily consumable. Assets in this sense include monuments, museums, and other edificial items or works of art.

20. <u>Liabilities</u>. Liabilities are probable future sacrifices of economic benefits stemming from legal, equitable, or constructive (moral and custom) requirements of the entity to transfer assets or provide services to others in the future as a result of past transactions or events affecting the entity.

<u>Characteristics of liabilities</u>.

A. The three essential characteristics of liabilities are (1) an entity has a legal, an equitable, or a constructive (moral and custom) duty to transfer or use assets at a specified or determinable date, or on occurrence of a specified event, or on demand, (2) the duty binds the entity, leaving it little or no discretion to avoid future sacrifice, and (3) the transaction, event, or circumstance that binds the entity has already occurred. Generally, to qualify as a liability, an item must have all three characteristics. Liabilities are represented by claims of persons or other entities (whether their identities are known or not) against the assets of the entity being accounted for. Liabilities have been traditionally based on actual or probable legally enforceable claims; however, liabilities are also recognized as equitable, moral, or customary requirements to satisfy or settle the claims.

B. Liabilities take on various forms and basically require use of or transfer of assets. The assets used to settle the liability can be specified or not. The liability can require the entity to pay cash or transfer other assets or to provide or to be ready to provide services. Once incurred, liabilities continue to remain liabilities until they are settled in full by transfer or use of assets or otherwise fully satisfied by the occurrence of events or circumstances discharging any further requirement under the liabilities.

21. Equity of the U.S. Government. Equity of the U. S. Government is the residual value of the entity after accounting for all liabilities at any time and is the cumulative net

results of past transactions, events, and circumstances affecting the entity.

Characteristic of equity of the U.S. Government

A. The essential characteristic of this element is that it is the residual claim to assets after deducting all liabilities and is represented by:

1. The cumulative results of operations of all periods. (See par. 22.)

2. The cumulative donations of assets or services not reflected in the results of operations either received or transferred out without required renumeration or without incurrence of a liability on the part of the recipient for all periods.

3. Other cumulative effects on assets or liabilities resulting in a change in the difference between assets and liabilities for all periods not recognized through results of operations or donations.

The residual claim to assets refers to the future benefits to be derived from assets net of liabilities at a time which will help enable an entity to achieve its mission. It is not the residual claims to assets after creditors' claims which owners have in private businesses. Rather, it represents net resources available to an agency to conduct program activity. It is not a form of ownership controlled by special interest groups, and it cannot be freely transferred, traded, or valued as an asset or resource from which income is derived in the accounts of specific identified owners. Rather, it is the net investment by society (or any agent or representative of that society) in an entity which is available for use to enhance the safety, welfare, and overall living standards of society.

B. The results of operations affect the equity of the U.S. Government periodically. They are the net difference between income, costs, and gains and losses over a period of time resulting from numerous transactions, and they are periodically entered in the equity of the U. S. Government. Donations are specifically the intention of the donor and when received, as represented by cash or other goods or services, increase the equity of the U. S. Government when such cash, goods, or services either have: (1) useful lives or provide benefits to the recipient government agency extending beyond the period in which they were received or (2) represent investment by one entity in another for commencing or continuing certain operations. Donations which are transferred out and which are not included in the results of operations decrease the equity of the U. S. Government. Other effects on the equity of the U. S. Government not included in results of operations or donations but which change the difference between assets and liabilities involve such items as discovery; adverse possession; exercising rights of eminent domain; forgiveness of debt; results of war; receipt of echeted assets; or, in the case of Government corporations, dividends declared.

C. Equity of the U. S. Government may be restricted or unrestricted. Unrestricted equity indicates in concept that assets, to the extent they exceed liabilities and restricted equity, are available to management for accomplishing the entity's mission. Restricted equity indicates that certain assets of the entity have been earmarked to be used for specific purposes or to be used a specific way. The assets may be specifically identified or not. Equity in this sense closely approximates liabilities; however, the difference lies in the duty to transfer assets and the transaction that binds an entity. Each of these two qualifications are necessary criteria for an item to be considered a liability. However, restricted equity may not represent a specific duty to transfer assets or may not result from a specific transaction that binds an entity. Examples include nonexpendable or otherwise restricted trust or agency agreements under which the entity is trustee or agent for other persons or entities.

22. Results of operations. Results of operations are the change in the equity of the entity over a period of time resulting from operations which were reasonably expected to occur and which affect an entity in carrying out its mission.

Characteristics of results of operations

A. The essential characteristics of the results of operations are (1) they are the summation of transactions, events, or circumstances over a specified period, (2) the combination of these transactions, events, or circumstances results in a change in the equity of the U. S. Government, and (3) these transactions, events, or circumstances were expected to occur or could reasonably have been expected to occur considering all risks in conducting the entity's programs and activities. Generally, results of operations have all three characteristics.

B. The summation of transactions, events, or circumstances over a period of time refers to the combination of all income, costs, and gains and losses over a specified period during which the entity is actively seeking to achieve its program objectives. Results of operations, in general terms, help show the accomplishments of the entity and its efforts for a designated period. Results of operations are the net of income, costs, and gains and losses into one item or amount which results in a change in equity. In a sense, the results of operations compare an entity's unrestricted equity at the end of the period with that existing at the beginning of the period. Although the results of operations might have no effect on equity, for all practical purposes they always result in a change in equity. However, regardless of the effect on equity, the results of operations also help show the program activity for the period. Results of operations consist of income, costs, and gains and losses that are associated with carrying out an entity's programs. This includes consideration of all risks, normal and remote, associated with the entity's programs, no matter how small or large they may appear to another agency or another program. This includes income, costs, gains and losses, no matter how frequently or infrequently they occur, so long as they could be associated with conducting intended program activity. In this sense, they would result in a change in equity to the extent they excluded donations and other changes in equity. (See par. 20B.)

23. Income. Income is an increase in assets over liabilities resulting from services provided by the entity, assets delivered to purchasers, taxes levied directly or indirectly on the public, and other activities that constitute the entity's major or central operations.

Characteristics of income.

A. The essential characteristics of income are that (1) it results in an increase in assets, a decrease in liabilities, or any combination of changes in assets and liabilities resulting in an increase in assets related to liabilities, (2) it is directly associated with an entity's programs and activities, and (3) it is earned, transferred to the entity, or otherwise levied by the entity. Generally, to qualify as income, all three characteristics must be present.

B. Income usually results in the actual or potential receipt of cash or the deposit of cash for use by an entity. However, income can result in actual or potential receipt of any asset, a decrease in any liability, or any corresponding change in both assets and liabilities resulting in an increase in assets over liabilities. Income may be identified as the result of a specific transaction, an event, or a circumstance, or it may be identified as a sum total over a period of time. In either case, income by itself has the effect of increasing equity of the U. S. Government, although it is usually combined with costs and gains and losses as results of operations before being adjusted into the equity. Income is also a result of an entity's major operations and is anticipated as necessary to directly carry out its programs and activities. It is not the result of ancillary or incidental transactions or events. Rather, it is expected as normal, recurring, and necessary to achieve desired program results.

C. The third characteristic of revenue is that it can be classified as either earned or not earned. If it is earned, it is actively sought by the entity in the sense that specifically identified assets (goods and services) have been exchanged for it. The entity has sold goods or services. Income not earned includes transfers of assets to the entity or assets levied by the entity, both of which do not involve the sale or transfer of specifically identified assets. Income which is not earned is either levied on the public, usually in the form of taxes under the sovereign power of the Federal Government, or provided to the entity, which permits it to incur costs and authorize payments from the Treasury for specific purposes.

24. Costs. Costs are the outflow or other using up of assets or the incurrence or increase of liabilities during a specific period in carrying out the entity's major operations.

Characteristics of costs.

A. The essential characteristics of costs are that they (1) involve a spending process which results in a decrease in assets; an increase in liabilities; any combination of changes in assets and liabilities resulting in an increase in liabilities related to assets; or a definite administrative action which is intended to, and which will, result in an increase in liabilities related to assets, (2) are directly associated with the entity's programs and activities and (3) are incurred for the purpose of procuring assets (goods or services) or awarding transfer payments (grants or subsidies). To qualify as a cost, any part or combination of all three characteristics must be present.

B. Costs may be identified as the result of a specific transaction, an event, or a circumstance, or they may be identified as a sum total over a period of time. In either case, costs by themselves have the effect of decreasing equity of the U. S. Government, although they are usually combined with income and gains and losses as results of operations before being adjusted into equity. Costs are also incurred under an entity's major operations and are anticipated as necessary to carry out its programs and activities. Costs are expected as normal, recurring, and necessary to achieve desired program results and are not the result of incidental transactions. Costs are also incurred for acquiring goods or services necessary to conduct operations or for making grants or subsidies required under various entity programs. The goods or services may be either consumed and/or received before, during, or after the period in which the costs are incurred. This depends upon the point in the spending process when costs are actually recognized.

C. Traditionally costs have been recognized in various phases of the spending process. Recognition has occurred (1) when an administrative reservation of spending authority occurs (obligation), (2) when goods or services are received or when a grant or subsidy recipient has met certain requirements entitling it to the grant or subsidy (expenditure), (3) when the goods or services are consumed (expense), or (4) when the goods or services are paid for (cash disbursement).

1. An obligation is incurred when goods and services are actually ordered or when a grant or subsidy request is actually awarded. The incurrence of an obligation is the earmarking of amounts from spending authority. The amount obligated is the estimated cost. However, an obligation is recorded for budgetary control and as such is generally not reported in traditional financial statements.

2. An expenditure is the financial measure of goods and services received during a specific period or a measure of grant and subsidy funds required to be paid to the recipient since the recipient has met the grantor agency requirements and is entitled to payment. Cost in this sense is input oriented in that it is a measure of goods and services acquired. The payment required for the goods and services received or grant and subsidy entitlements, regardless of the period in which payment is actually made, is the cost.

3. An expense is the financial measure of goods and services consumed during a specific period, whether or not it is paid for during the period. (For grant and subsidy activity, expenditure and expense are synonomus.) Cost in the expense sense is output oriented since it measures resources used to accomplish an activity, produce a unit of a good or service, or achieve a desired result.

4. Cash disbursement is the financial measure of resources paid for during the period. Cost in this sense is the actual outflow of cash. However, when cash disbursement is used as the financial measure of cost, it is not the accrual but rather the cash method of accounting.

The point in time in the spending process when costs should be recognized depends upon the entity being accounted for, as well as its programs and activities. Recognition requirements, however, are beyond the scope of this statement. Nevertheless, the point of recognition is critical to the discussion of costs and is presented here to provide a more complete definition and explanation of cost.

D. The operations of most Federal agencies are conducted from income in the form of appropriations from the Congress or in the form of subappropriations from executive agency authority to incur costs to administer programs and activities. Costs incurred under such authority are referred to as funded costs in the sense that moneys have intentionally been made available by that authority for eventual cash disbursements. Some agencies, however, do not require such authority to incur costs. In either case, some costs are actually incurred which are not "funded." Funding is not a prerequisite for the incurrence of costs. These costs are referred to as unfunded costs. Unfunded costs are incurred in the spending process as expenses, when goods or services have been consumed. Examples of unfunded costs include pension requirements actuarilly computed but unfunded, personnel leave, and depreciation or reserves for replacement of long-term property.

25. <u>Gains and losses</u>. Gains and losses are changes in the difference between assets and liabilities resulting from incidental transactions or extraordinary events.

<u>Characteristics of gains and losses</u>

A. The essential characteristics of gains and losses are that (1) gains result in an increase in assets, a decrease in liabilities, or any change in assets and liabilities resulting in an increase in assets related to liabilities, whereas losses result in a decrease in assets, an increase in liabilities, or any change in assets and liabilities resulting in an increase in liabilities related to assets and (2) they occur in operations as a result of peripheral or incidental transactions or as a result of unusual and extenuating events or circumstances. Gains and losses are the same as income and costs, since income affects assets, liabilities, and equity the same as gains, whereas costs affect assets, liabilities, and equity the same as losses. The difference, however, appears in how income and costs as opposed to gains and losses relate to an entity's program activity. Income and costs relate directly to program activity and are considered ordinary in the course of operation and as being central to achieving program objectives. Gains and losses relate only indirectly to program activity. Gains and losses, like income and costs, are reasonably anticipated to occur and at times can be considered necessary to achieve program objectives; however, they are usually immaterial compared with income and costs. The primary purpose of distinguishing gains and losses from income and costs is to give users of financial reports a statement showing direct program activity (income and costs) and indirect incidental activity.

B. Peripheral and incidental transactions and events are miscellaneous items that may arise either from exchange transactions which are not the normal transactions of the entity or not the result of normal risks. Examples include the sale of assets not normally sold in operations (such as fixed assets, Government securities, or lease rights to minerals) or payment of adjudicated claims of persons or other entities against the Government entity. Extraordinary gains and losses, unlike the other previously mentioned gains and losses (which are reasonably expected to occur on a relatively consistent basis), are rare and are associated only with remote risks of conducting operations. A prime example is the loss occurring from an unusual and unexpected natural disaster (an earthquake on the east coast).

Figure 1

EFFORTS IN THE FUNDAMENTAL LEVEL

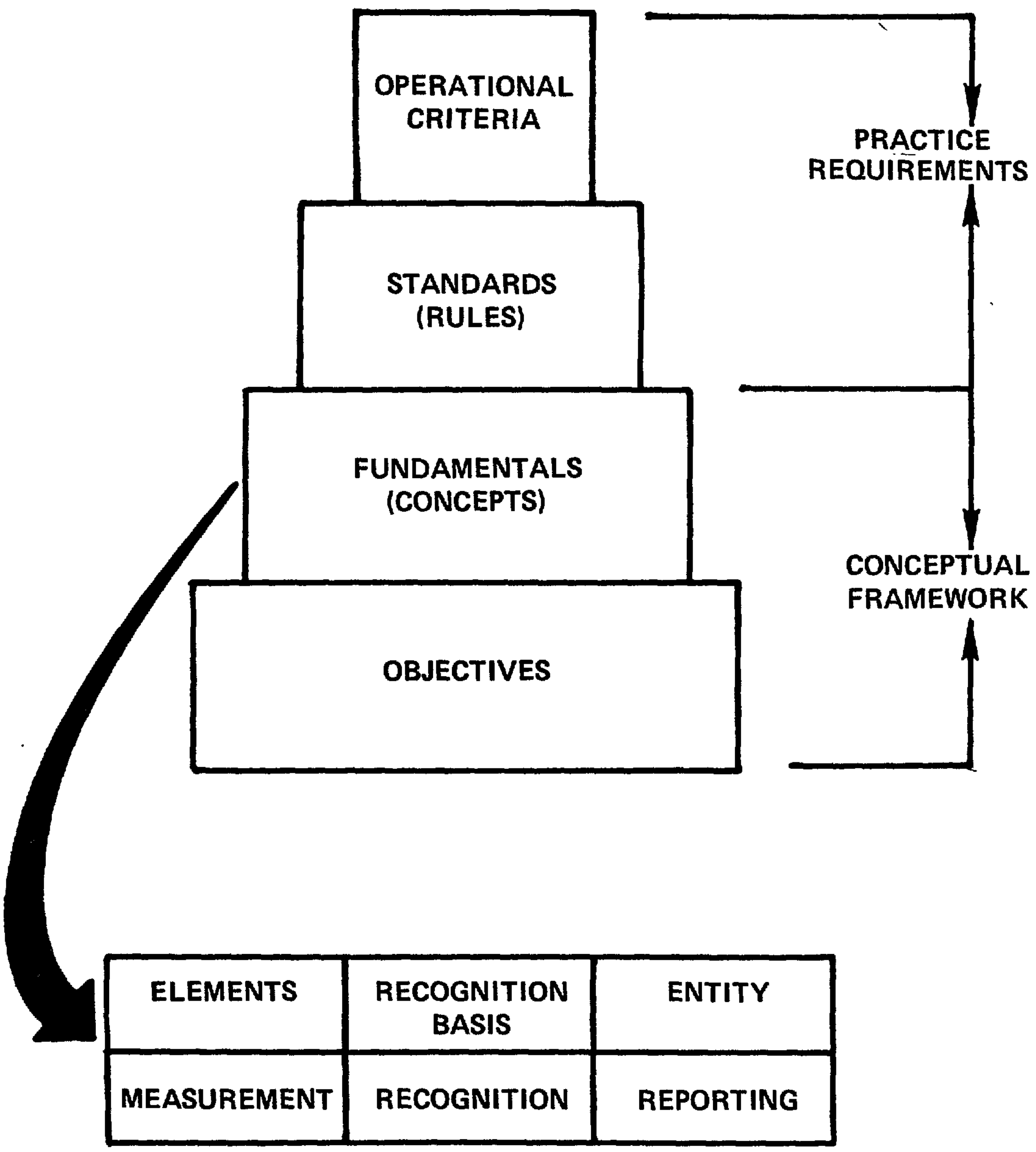

Figure 2

Brief Description of Efforts in the Fundamental Level

1.	Elements statement	This statement defines and explains components of financial reports. Examples include assets, liabilities, and costs.
2.	Entity statement	This statement establishes the body or activity about which financial reports will be prepared.
3.	Recognition basis statement a/	This statement analyzes the three basic theories of financial reporting (funds flow, income determination, and capital maintenance) and recommends which one applies to the Federal Government.
4.	Measurement statement	This statement deals with valuation criteria to be used in establishing and maintaining standards on assigning dollar amounts to elements and components of elements.
5.	Recognition statement a/	This statement establishes criteria to be used when establishing and maintaining standards on when to report elements and components of elements.
6.	Reporting statement	This statement establishes the criteria to guide in developing and maintaining standards on report formats and the degree of disclosure required in reports.

a/ If the effort required to determine the recognition basis is readily completed, it may be incorporated in the recognition paper.